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The Global Expansion Continues

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The world economy continues to expand at a healthy pace, buoyed by strong growth in most emerging markets and by steady growth in most advanced economies. Commodity prices are firm, inflation remains contained almost everywhere, unemployment in the OECD countries is declining and financial markets (with the exception of those dealing with bitcoins) are relatively calm. Barring any major shocks, steady, if slightly slower, growth should continue into 2019 and 2020.

The two largest economies (China and the United States) are both witnessing some modest monetary tightening. In China this has, so far, hardly impinged on the country's growth rate, but a deceleration is, nonetheless likely over the medium term. Corporate debt remains high, the construction sector is fragile and excess capacity plagues numerous industrial sectors. In addition, the necessary shift of demand from investment to consumption will also slow down economic growth. In the US the economy's momentum remains relatively strong and somewhat higher short-term interest rates are unlikely to act as a major brake. The economy is, however, very close to full employment and the recent, unfunded and controversial, tax-cuts package could add not just to public debt but also to inflation. Should this happen, a sharper monetary policy correction is possible.

In the developing world Brazil has shrugged off its recent recession and India has shrugged off the forced conversion of its higher denomination banknotes as well as the turmoil that followed the imposition of a national sales tax. In many other emerging markets foreign indebtedness remains relatively high, but, so far at least, the rise in US interest rates has had hardly any negative effects on currency values. Problem areas remain, particularly in the Middle East, in view of continuing political turmoil and relatively weak oil prices, but, elsewhere, overall prospects look fairly solid.

Europe is sharing in this global upswing. Particularly encouraging are developments in Eastern Europe. Russia has clearly emerged from recession. Longer-run problems have not gone away, but inflation seems under control and steady, if modest, growth is in prospect. Central Eastern Europe is literally booming. Romania may have recorded (an unsustainable) 7 per cent growth last year; the Czech Republic, Hungary, Poland, Slovakia and, of course, also Romania are all heading for growth of 3 to 4 per cent in 2018. Even Turkey, despite high inflation, a weak exchange rate and political difficulties, has seen an acceleration, thanks in part to easier policies. Here too, growth this year could be as high 4 per cent.

In Western Europe some disappointment has come from the UK. Growth has moderated as both private consumption and investment have slowed down in the wake of Brexit-induced effects. Sterling's sharp depreciation has raised inflation to 3 per cent, with no concomitant increase in wages. The resulting squeeze on household income has reduced the growth in spending. As for investment, this is inevitably being influenced, at least in the tradeable sector, by the pervasive uncertainty as to the future relations with the EU. Sadly, estimates suggest that, on the basis of past trends and pre-Brexit forecasts, Brexit may have already reduced British output by perhaps 1 per cent from the level it might otherwise have reached at end-2017. Paradoxically, this works out at a loss of some £ 350 million per week, virtually the same amount that ardent pro-Brexiters (falsely) claimed the British National Health Service could gain from leaving the EU.

The Eurozone, on the other hand, has continued to grow at a rate that few thought possible only one or two years ago. Expansion in the rest of the world, as well as a relatively weak euro, are supporting exports. And domestic demand is helped by modestly stimulatory fiscal policies and by continuing monetary accommodation. Growth is expected to be particularly rapid this year in Germany, Austria, Finland as well as in Spain (despite Catalonia) and in Ireland (despite Brexit), while remaining solid in France and in the Netherlands.

What are the main economic risks facing this favourable scenario? Europe's past recessions were sparked off by domestic monetary policy tightening consequent on high rates of inflation (1981-82, 1992-93), by the bursting of unsustainable financial bubbles (2008-09), or by fiscal austerity designed to reduce public debt (2012-13). None of these dangers is particularly apparent at present. Inflation is subdued, even in Germany, despite the country's virtual full employment. It is true that the European Central Bank is envisaging some monetary tightening, but present indications suggest that this will be very moderate. Financial markets are robust, but in Europe at least (as opposed to the United States stock market) there is hardly any indication of inflated asset prices (other than for bitcoins). And fiscal austerity has given way to a much more accommodating stance in most Eurozone countries. A world-wide shift to protectionism would, undoubtedly, hurt growth prospects, but, for the time being at least, this does not seem to be on the cards.

Other risks are of a political nature. The Middle East continues to be in turmoil and an oil price shock remains a possibility should the turmoil worsen. Fortunately, however, the world is now less reliant on a single source of energy than it was over the last three decades. In Europe political uncertainties abound and populism, if in retreat, remains a threat. Germany may have to live without a strong government for some time to come, Spain is still facing its Catalonia dilemma and Italy will go the polls in March. Spain's economy has, so far, suffered very little from the Catalan events and, hopefully, given the country's recent strong performance, this absence of negative effects will continue. Italy's prospects are more worrying. The likely absence of a solid parliamentary majority in the next legislature could make for weak policies and this in a country whose recovery is still modest and whose public debt level remains very high. Eurozone tensions may, in other words re-emerge.

GDP GROWTH RATES (%)

	2016	2017	2018	2019	2020
Eurozone	1.8	2.4	2.2	1.7	1.5
United Kingdom	1.8	1.5	1.5	1.6	1.9
United States	1.5	2.3	2.7	1.9	1.5
China	6.7	6.8	6.4	6.0	5.7
World	2.4	3.0	3.2	2.9	2.7

Source: Oxford Economics